

Message Text

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ORIGIN EB-07

INFO OCT-01 EUR-12 ISO-00 SSO-00 NSCE-00 CCO-00 SS-15

NSC-05 NEA-10 TRSE-00 /050 R

DRAFTED BY EB/IFD/OMA:CCCUNDIFF:DLS/EB/FSE:LBUTCHER;

APPROVED BY EB/IFD:PHBOEKER

EB/FSE:LRAICHT

EUR/RPE:EPREEG

NEA:SSOBER

EUR/NE:NACHILLES

E:RMORRIS

TREAS: DSYVRUD (SUBS)

S/S: MR. BORG

EUE/AHARTMAN

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FM SECSTATE WASHDC

TO USDEL SECRETARY IMMEDIATE

INFO USMISSION OECD PARIS IMMEDIATE

C O N F I D E N T I A L STATE 156457 TOSEC 050096

E.O. 11652: GDS

TAGS: ENRG, EFIN

OECD PARIS PASS TO ENDERS

SUBJECT: RESPONSE FOR AMBASSADOR RICHARDSON TO HAROLD
LEVER'S VIEWS ON OIL PRICE/OIL MONEY PROBLEM

S/S NO. 7513362

ACTION MEMORANDUM TO THE SECRETARY FROM EB - PAUL H.
BOEKER, ACTING

1. LEVER'S LATEST IDEAS (RELAYED THROUGH AMBASSADOR
RICHARDSON IN LONDON 10004) INDICATE A WILLINGNESS TO
STRIKE A DEAL WITH THE PRODUCERS WHICH WOULD ENCOMPASS BOTH
INDEXATION OF OIL PRICES AND OIL PRODUCERS' FINANCIAL
ASSETS. HIS MAIN ASSUMPTIONS ARE THAT: (A) OPEC IS TOO
STRONG TO COLLAPSE; (B) IT HAS THE POWER TO INCREASE THE
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MONOPOLY PRICE OF OIL MUCH HIGHER AND FOR THE MOMENT

IS CONSTRAINED FROM DOING SO ONLY BY POLITICAL CONSIDERATIONS; (C) TO IMPROVE UPON AN INCREASINGLY ADVERSE SITUATION, THE CONSUMERS HAVE A CHOICE BETWEEN EVENTUAL WAR WITH THE PRODUCERS OR CONCLUDING AN AGREEMENT WHICH "CONSOLIDATES AND VALIDATES" THE PRODUCERS' PRICE GAINS. THIS WOULD ENTAIL NOT ONLY INDEXATION OF OIL PRICES OVER A NUMBER OF YEARS IN EXCHANGE FOR ASSURANCES ON SUPPLY, BUT ALSO SETTING UP SPECIAL ARRANGEMENTS FOR OPEC FINANCIAL SURPLUSES. LEVER THINKS THAT PRIME MINISTER WILSON WILL SUPPORT HIS VIEWS AND PUT THEM FORWARD TO SCHMIDT AND

GISCARD AT JULY 16-17 EC SUMMIT. WE OF COURSE HAVE GREAT DIFFICULTY WITH BOTH LEVER'S ASSUMPTIONS AND HIS PROPOSED SOLUTIONS, WHICH APPEAR COLORED BY HIS PERCEPTION OF UNIQUE PROBLEMS FACING THE U.K.

RECOMMENDATION: THAT YOU APPROVE THE FOLLOWING DRAFT CABLE TO AMBASSADOR RICHARDSON.

APPROVE-----DISAPPROVE-----

THIS HAS BEEN CLEARED BY EUR, NEA, AND E.

ATTACHMENT: ACTION: AMEMBASSY LONDON, INFO: OECD PARIS, PARIS, BONN
REF: LONDON 10004
FOR AMBASSADOR RICHARDSON FROM THE SECRETARY
SUBJECT: OIL PRICE/OIL MONEY PROBLEM
EO 11652: GDS
TAGS: EFIN, ENRG

1. YOU ARE RIGHT, HAROLD LEVER'S VIEWS ON INDEXATION OF OIL PRICES AND SPECIAL ARRANGEMENTS FOR OIL PRODUCERS' FINANCIAL ASSETS ARE NOT NEW. BECAUSE THESE VIEWS HAVE NOW BEEN PRESENTED TO US IN SOME DETAIL, HOWEVER, IT IS IMPORTANT THAT WE GIVE A FULLER RESPONSE THAN WE HAVE UP TO NOW. LEVER CONTINUES TO ASSUME THAT FINANCING IS THE HEART OF THE ENERGY PROBLEM. THIS MAY BE

TRUE TO SOME EXTENT OF THE U.K. IF IT IS BETTING THAT THE
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NORTH SEA WILL SAVE IT IN TIME FROM OPEC AND IT NEED ONLY BANKROLL ITSELF UNTIL THEN. BUT BEYOND THE U.K., IT IS CLEAR THAT FINANCING IS NOT THE HEART OF THE CONSUMER COUNTRIES' PROBLEM. WHATEVER THE MERITS OF HIS APPROACH IN THE U.K. CONTEXT, IT WOULD PROVE CORROSIVE TO CONSUMER COOPERATION IN GENERAL IN THE IEA. I HOPE, THEREFORE, THAT YOU CAN FOLLOW-UP WITH LEVER PROMPTLY EXPLAINING THE REASONS WHY THE USG DOES NOT

SHARE HIS ASSESSMENT, DRAWING ON THE FOLLOWING.

2. ONE OF THE BASIC PREMISES OF LEVER'S ARGUMENT IS THAT PRICE STABILITY AND BROADER FINANCIAL PROBLEMS ARE AT THE HEART OF ENERGY CRISIS. THIS IS NOT OUR ASSESSMENT. AN INDEXATION SOLUTION, WHILE PROVIDING SOME RELIEF TO OIL CONSUMERS BY AFFORDING A MEASURE OF STABILITY TO FUTURE PRICES, LEAVES THE PRIMARY THREAT IMPLIED BY CONTINUING DEPENDENCE ON OPEC OIL UNRESOLVED. THE MAJOR TASK FACING INDUSTRIALIZED OIL CONSUMERS IS HOW TO REDUCE THEIR DEPENDENCE ON OPEC AND

THUS THEIR LONG-TERM VULNERABILITY TO OPEC PRESSURES. LEVER'S SOLUTION DOES NOT ADDRESS THIS PROBLEM, AND COULD IN FACT WORSEN IT BY WEAKENING CONSUMER RESOLVE TO DEAL WITH UNDERLYING CAUSES OF PRESENT SITUATION.

3. OBJECTIONS TO OIL PRICE INDEXATION: INDEXATION OF OIL PRICES IS NOT TO THE ADVANTAGE OF CONSUMER COUNTRIES WITH PRICES AT PRESENT HIGH LEVEL. THE ONLY SITUATION IN WHICH INDEXATION COULD BE CONSIDERED TO OUR ADVANTAGE WOULD BE IF OIL PRODUCERS WERE PREPARED TO ACCEPT SUBSTANTIAL REDUCTION IN OIL PRICE IN RETURN FOR SOME FORM OF INDEXING. WE SEE NO SIGN OF PRODUCER WILLINGNESS TO ACCEPT SUCH A SUBSTANTIAL PRICE DECLINE. HOWEVER, EVEN IN THESE CIRCUMSTANCES WE WOULD FACE MAJOR PROBLEMS: (A) AN AGREEMENT TO INDEX OIL PRICES COULD REINFORCE INFLATIONARY PRESSURES AS EXPECTATION OF HIGHER OIL PRICES WOULD PROMPT OTHER WIDESPREAD PRICE RISES IN OUR ECONOMIES.

(B) THIS INFLATIONARY IMPACT WOULD BE EXACERBATED BY FACT THAT ONCE INDEXATION FOR OIL AGREED TO, IT WOULD BE CONFIDENTIAL

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VERY DIFFICULT TO DENY OTHER COMMODITIES EQUAL TREATMENT. THIS IN TURN WOULD FEEDBACK TO OIL PRICES THROUGH INDEXATION SCHEME.

(C) INDEXATION BY DEFINITION REMOVES OIL PRICE FROM DETERMINATION BY DEMAND AND SUPPLY FOR OIL. SINCE OPEC IS UNLIKELY TO ACCEPT INDEXATION SCHEME WHICH WOULD PERMIT OIL PRICE TO FALL, THIS WOULD SHIFT RISK NORMALLY SHARED BY BOTH OIL PRODUCERS AND CONSUMERS ONTO LATTER ALONE.

(D) WE COULD NOT REALISTICALLY EXPECT ARAB OIL EXPORTERS TO FOREGO THE USE OF OIL AS A POLITICAL WEAPON IN EXCHANGE FOR INDEXATION.

(E) FINALLY, A SCHEME CONCLUDED WITH ALL OPEC PRODUCERS

ELIMINATES ANY POSSIBILITIES WE MAY HAVE OF PLAYING SOME OFF AGAINST OTHERS. AS AMBITIOUS DEVELOPMENT PROGRAMS IN CERTAIN PRODUCERS BEGIN TO RESULT IN LEVELING OFF OR DECLINE IN CURRENT INCOME SURPLUS, SOME OF THEM MAY BECOME MORE INCLINED THAN AT PRESENT TO FIND WAYS TO INCREASE THEIR OUTPUT AT THE EXPENSE OF OTHERS. HOWEVER, A PRICE ARRANGEMENT GUARANTEED BY CONSUMERS WOULD SIGNIFICANTLY REDUCE PRESSURE WHICH SUCH BEHAVIOR MIGHT OTHERWISE EXERT ON THE CARTEL'S INTERNAL COHESION.

4. SPECIAL ARRANGEMENTS FOR OIL PRODUCER'S FINANCIAL ASSETS: THERE SEEMS NO NEED FOR INDUSTRIAL COUNTRIES TO

CREATE SPECIAL INVESTMENT OUTLETS, OR ESPECIALLY FAVORABLE TYPES OF ASSETS, FOR OPEC COUNTRIES.

(A) THE OPEC FINANCIAL SURPLUSES HAVE PROVED MANAGEABLE THROUGH PRIVATE MARKETS AND SPECIAL RECYCLING FACILITIES. INDUSTRIAL COUNTRIES ARE DEALING WITH THEIR FINANCING PROBLEMS ADEQUATELY WHILE ADDITIONAL MEASURES TO HELP THE DEVELOPING COUNTRIES ARE BEING WORKED OUT IN THE IMF AND IBRD.

(B) THERE IS NO NEED TO OFFER SPECIAL INDUCEMENTS FOR OPEC CAPITAL TO FLOW INTO THE INDUSTRIAL NATIONS WHEN THERE ARE NO OTHER MAJOR CAPITAL MARKETS INTO WHICH SUCH FUNDS CAN GO.

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(C) AS OIL PRODUCER ASSETS BUILD UP, INCENTIVE FOR THEM TO CONTINUE TO INVEST RESPONSIBLY WILL INCREASE BECAUSE OF

SUNK INVESTMENT IN INDUSTRIAL COUNTRIES.

(D) CONSOLIDATION OF OIL PRODUCER INVESTMENTS INTO AN INTERNATIONAL MUTUAL FUND OR DIRECT INVESTMENT POOL COULD INCREASE THEIR COLLECTIVE DISRUPTIVE POWER, WHILE ON THE OTHER HAND WE HAVE NO INDICATION THAT INDIVIDUAL PRODUCERS WANT TO GIVE UP THEIR PRESENT FREEDOM OF PORTFOLIO MANAGEMENT.

(E) SHOULD THE OIL PRODUCERS ENGAGE IN DISRUPTIVE SHORT-TERM CAPITAL MOVEMENTS, THE INDUSTRIAL COUNTRIES HAVE AN OFFSETTING CAPABILITY THROUGH A VARIETY OF INTERNATIONAL MONETARY MECHANISMS, INCLUDING CENTRAL BANK SWAPS AND OVER THE LONGER TERM THE OECD FINANCIAL SUPPORT FUND.

(F) MOST IMPORTANT, PERHAPS, GRANTING TO OIL-RICH FOREIGNERS A GUARANTEE AGAINST LOSS OF PURCHASING POWER OR PROTECTION AGAINST ANY OTHER INVESTMENT LOSS IS

POLITICALLY DIFFICULT TO DO WHEN SUCH ASSURANCES ARE NOT GIVEN TO DOMESTIC INVESTORS AND CONSUMERS.

(G) FINANCIAL BENEFITS TO THE OIL PRODUCERS ABOVE NORMAL MARKET TERMS ADD TO THE PRESENT AND FUTURE BURDEN OF HIGHER OIL PRICES, CONCEIVABLY OFFSETTING ADVANTAGE FROM LOWER OIL PRICES SHOULD THAT OCCUR.

5. WE WOULD APPRECIATE YOUR VIEW OF DEGREE TO WHICH LEVER'S POSITION IS COLORED BY HIS PERCEPTION OF UNIQUE PROBLEMS FACING THE U.K. DOES HE SEE U.K. IN SHORT RUN EXTREMELY VULNERABLE TO ANOTHER ROUND OF SUBSTANTIAL OIL

PRICE INCREASES? IS HIS ARGUMENT FOR INDEXATION A STOP-GAP MEASURE UNTIL NORTH SEA OIL BRINGS SELF-SUFFICIENCY? IS THERE ANY INDICATION OTHERS WITHIN THE U.K. GOVERNMENT, INCLUDING PRIME MINISTER, ARE BEING PERSUADED BY LEVER'S ARGUMENT? INGERSOLL

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: PETROLEUM, TOSEC, IMPORTERS, EXPORTERS, PRICES, FOREIGN INVESTMENTS
Control Number: S7513362
Copy: SINGLE
Draft Date: 02 JUL 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: CunninFX
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975STATE156457
Document Source: CORE
Document Unique ID: 00
Drafter: CCCUNDIFF:DLS/EB/FSE:LBUTCHER;
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D750229-0970
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750790/aaaadcwe.tel
Line Count: 240
Locator: TEXT ON-LINE, ON MICROFILM
Office: ORIGIN EB
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: CunninFX
Review Comment: n/a
Review Content Flags:
Review Date: 14 MAY 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <14 MAY 2003 by ShawDG>; APPROVED <02 OCT 2003 by CunninFX>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: RESPONSE FOR AMBASSADOR RICHARDSON TO HAROLD LEVER'S VIEWS ON OIL PRICE/OIL MONEY PROBLEM
TAGS: ENRG, EFIN, (LEVER, HAROLD)
To: SECRETARY
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006